

G-008/C-91-942 ORDER ESTABLISHING ACCOUNTING PROCEDURES AND  
REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Complaint  
of the Minnesota Alliance for  
Fair Competition Against  
Minnegasco, a Division of Arkla,  
Inc.

ISSUE DATE: November 10, 1992

DOCKET NO. G-008/C-91-942

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PROCEDURES AND REQUIRING FURTHER  
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**PROCEDURAL HISTORY**

**I. Proceedings to Date**

**A. The History of this Docket**

On November 27, 1991 the Minnesota Alliance for Fair Competition (MAC), a trade organization of plumbing, electrical and appliance associations, filed a complaint against Minnegasco, a regulated gas utility. The complaint alleged that Minnegasco subsidizes its unregulated appliance sales and service operations through its regulated utility operations, offers preferential treatment to ratepayers who use its appliance sales and service operations, and uses its appliance inspection service to manipulate ratepayers into purchasing appliances from Minnegasco. MAC asked the Commission to convene a formal hearing on its claims, grant it discovery rights, require Minnegasco to sever all ties between its appliance sales and repair operations and its regulated utility operations, and require Minnegasco to refund money it had allegedly obtained from a customer by fraud.

On January 29, 1992 the Commission issued its ORDER SEVERING MINNEGASCO FROM THE INVESTIGATION DOCKET, GRANTING DISCOVERY RIGHTS, REQUIRING REPORT AND AUTHORIZING COMMENTS. That Order removed Minnegasco from an ongoing generic investigation of appliance sales and service operations by regulated utilities and established this complaint docket. It also granted MAC discovery rights and required MAC to file a report on the results of its investigation.

## **B. MAC's Report**

On June 12, 1992 MAC filed its report. The report alleged numerous deficiencies in Minnegasco's cost allocation procedures, continued preferential treatment of ratepayers using the Company's appliance sales and repair operations, and conflict of interest between the Company's duty to provide safe and reliable service and its commitment to selling and repairing appliances. MAC asked the Commission to require the Company to segregate its appliance sales and repair operations into a structurally separate business organization.

## **C. Minnegasco's Filings**

In its reply to the MAC report, Minnegasco denied all allegations of impropriety. The Company also claimed that its unregulated appliance sales and repair operations reduce the costs (and rates) of its regulated operations by sharing fixed costs that would otherwise be paid entirely by ratepayers. The Company believed its ongoing general rate case was the best vehicle for deciding cost allocation issues.

On September 8, 1992 the Company filed a Motion Concerning Resolution of MAC Complaint. In that motion the Company asked the Commission to defer all cost allocation issues to its ongoing rate case, to dismiss MAC's claims of preferential treatment and conflict of interest, and to deny MAC's request to order complete structural separation of the Company's regulated and unregulated operations.

## **D. Other Parties' Filings**

The Department recommended specific changes in Minnegasco's cost allocation procedures, did not find a pattern of preferential treatment toward ratepayers who use the Company's appliance sales and repair services, did not believe Minnegasco's safety responsibilities were being compromised by its unregulated operations, and saw no need to require the Company to operate its appliance sales and repair business as an independent enterprise. The Department recommended that any issues not resolved in this docket be referred to the Company's ongoing general rate case.

The Residential Utilities Division of the Office of the Attorney General (RUD-OAG), too, recommended changes in the Company's cost allocation procedures. Like the Department, the RUD-OAG did not believe the Company's appliance sales and service operations were compromising system safety or resulting in preferential treatment of ratepayers using those services. Finally, the RUD-OAG recommended requiring the Company's unregulated operations to pay the utility a license fee for the use of the Minnegasco name.

## **E. Commission Consideration**

The matter came before the Commission on October 29, 1992. The Commission heard oral argument from MAC, the Company, the Department, and the RUD-OAG. Having examined the entire record herein and having heard the arguments of counsel, the Commission makes the following findings, conclusion, and order.

## **FINDINGS AND CONCLUSIONS**

### **III. Commission Action**

#### **A. The Commission Will Address Cost Allocation and Accounting Issues in this Docket**

The Company urged the Commission to defer the cost allocation issues in this docket to the general rate case, where they could be considered in conjunction with similar issues, such as jurisdictional cost allocations. The Company pointed out that the Commission's August 17, 1992 Order accepting the rate case filing<sup>1</sup> stated that cost allocation issues would be addressed in the rate case.

The Commission notes that the August 17 Order said only that cost allocation issues would be addressed in the rate case, not that cost allocation issues would be addressed exclusively in the rate case. The Order did not close this complaint docket, and in fact required that rate case filings relating to regulated/unregulated cost allocations be filed in both dockets. Clearly, the August 17 Order did not determine which decisions would be made in which docket, just that the dockets and decisions were interrelated.

The Commission believes that it would be best to make basic cost allocation decisions in this docket. There are two reasons for this approach.

First, this is the third docket in which MAC has attempted to have its subsidization claims resolved. The first was the Minnegasco/Arkla merger docket, in which the Commission determined that MAC's issues were not sufficiently related to merger issues to be considered there.<sup>2</sup> The second was the

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<sup>1</sup> In the Matter of the Application of Minnegasco, Division of Arkla, Inc., for Authority to Increase its Rates for Natural Gas Service in the State of Minnesota, Docket No. G-008/GR-92-400, ORDER ACCEPTING FILING AND SUSPENDING RATES (August 17, 1992).

<sup>2</sup> In the Matter of the Proposed Merger of Minnegasco, Inc. with and into Arkla, Inc., Docket No. G-008/PA-90-604.

generic appliance sales and service investigation docket, in which the Commission determined that the fact-specific issues MAC was raising would be more appropriately examined in a complaint proceeding.<sup>3</sup> Now that MAC has initiated a complaint proceeding, the Commission is loath to refer MAC to yet another docket in the absence of compelling need.

Furthermore, the Commission believes this docket is a better vehicle than a rate case for considering many of MAC's issues, which include not only traditional rate case issues such as cost allocation, but allegations of discriminatory treatment of ratepayers, exploitation of vulnerable consumers, and threats to the provision of safe and reliable service. The Commission believes this proceeding will allow more focused consideration of such issues than the rate case.

**B. The Commission Will Require the Company to Adopt the Cost Separations Principles Developed by the Federal Communications Commission**

The Commission has reviewed MAC's claims of misallocations resulting from Minnegasco's procedures for separating the costs of regulated and unregulated operations, and the analyses submitted by other parties. Some of MAC's claims reflect misunderstandings of appropriate accounting practices. Others pinpoint inadequacies in Company practice. On the whole, MAC's allegations have highlighted the need for the Company to replace existing ad hoc allocation procedures with a cohesive and comprehensive approach to cost separations. Each of MAC's claims relating to the Company's accounting practices will be examined below.

**1. Technician Time**

MAC challenged Minnegasco's practice of allocating technician work time on the basis of payroll records, claiming the Company's Service Management Account Record Tracking (SMART) system showed more technician time being devoted to unregulated operations than payroll records. (Payroll records show technicians devoting 31.75% of their time to regulated operations; SMART records show 20.64%.) The Company claimed the SMART system was a management tool, not a timekeeping system, and that payroll records were more accurate for purposes of determining how individual technicians actually spent their time.

The Commission finds this discrepancy between payroll records and SMART records disturbing. The difference between the two percentages is significant and translates into significant amounts of money. Company statements that the Company knows which records are more precise, and that the more precise records

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<sup>3</sup> In the Matter of an Investigation into the Competitive Impact of Appliance Sales and Service Practices of Minnesota Gas and Electric Utilities, Docket No. G,E-999/CI-90-1008.

favor unregulated operations, are less than reassuring. Similarly, Company statements that payroll records provide a more accurate account of how employees spend their time than SMART records is counter-intuitive. While the time record discrepancy alone might not justify overhauling the Company's separations practices, it lends additional weight to other concerns. Together, they point to a need to improve allocations procedures.

## **2. Allocating Technicians' Non-Productive Labor Time**

MAC challenged the Company's practice of allocating non-productive labor expense based on the payroll records for productive labor, pointing again to the discrepancy between payroll records and SMART records. MAC also claimed 70% of non-productive labor time was spent in training, and that 75% of that training related to unregulated operations. The Company said most non-productive labor time was attributable to vacation, sick leave, and break time, that only 16% was spent in training, and that 30.25% of that training related to unregulated operations.

The Commission accepts the Company's explanation that most non-productive labor time is attributable to paid leave and concludes MAC was mistaken in asserting that 70% of that time is devoted to training. At the same time, the Commission shares MAC's concerns about using payroll time records to allocate non-productive labor time. Given the imprecision of those records, applying them to another category of expense seems less than prudent; it obviously compounds the effects of any inaccuracies in the original time records.

The question of how much training time is devoted to topics related to unregulated operations is a harder one. The materials available do not provide a clear and immediate answer. The Commission believes that the issue of training time and the imprecision introduced by the payroll record allocation factor both point to a need for the Company to adopt more precise and coherent cost separations procedures.

## **3. Allocating Non-labor Expenses**

MAC challenged the Company's practice of allocating non-labor costs on the basis of the percentage of productive labor time devoted to regulated and unregulated operations. This practice raises all the accuracy issues arising from the discrepancy between payroll records and SMART time records. It also raises questions about the factual basis for allocating costs that have little to do with labor, such as the cost of providing warehouse space and computer technology, based on the percentage of time specified employees spend on regulated and unregulated operations. The Commission believes the Company's treatment of non-labor expenses demonstrates the need for more carefully developed cost allocation practices.

#### **4. Compensation of Appliance Sales Personnel**

MAC pointed out that until 1992, the same Minnegasco employees were responsible for promoting the expansion of natural gas use (e.g., in new residential subdivisions) and for selling natural gas appliances. Their salaries and benefits were allocated to the regulated utility. Sales commissions were allocated to unregulated operations. In 1992 the unit, the Residential New Business department, was reorganized, and sales functions were transferred to a new department funded by unregulated operations.

The Commission agrees with MAC that the pre-1992 Residential New Business department can be viewed as a ratepayer-funded "no overhead" sales force. The cost allocation practices that department represents again demonstrate the need for more clear-cut cost allocation standards.

#### **5. No-Cost Services to Unregulated Operations**

Minnegasco provides certain services to its unregulated operations without charging any portion of their cost to the unregulated side of the ledger. These include regulatory expenses, the cost of developing the SMART system, and rent on certain offices occupied by employees who sell appliances in addition to other duties. The Company argues that expenses in these categories would not decrease if the unregulated operations ceased to exist. The Commission is not persuaded this is true. Unregulated operations clearly contribute to regulatory expenses, for example, as the cost of this docket demonstrate.

Furthermore, the Commission rejects the proposition that unregulated operations need not help cover costs that would exist even if unregulated operations did not. The purpose of cost separations is not to determine how much unregulated operations cost over and above the cost of running the regulated utility. The goal is to ensure that regulated and unregulated operations share equally in the economies resulting from integrated operations. To hold otherwise would result in a subsidy to unregulated operations.

#### **6. Return on Equity, Utility Name License Fee**

MAC pointed out that Minnegasco's unregulated operations do not pay a return on equity for the use of Company assets. The Commission believes that if cost separations are properly done, assets, or portions of assets, devoted to unregulated use will be excluded from rate base. The Commission intends to establish proper cost allocation procedures in this docket, making the return on equity issue moot.

MAC asked the Commission to require the Company's unregulated operations to pay the regulated utility a license fee for the use of the Minnegasco name. The RUD-OAG supported the request, but believed this record was inadequate for purposes of calculating such a fee. The Commission believes that imposing the FCC

separations principles will ensure proper allocation of costs between regulated and unregulated operations, eliminating any need to set a specific license fee for the use of the Minnegasco name.

## **7. FCC Separations Principles**

The Commission concludes, on the basis of its examination of this record, that Minnegasco's current cost allocation procedures do not identify the costs of unregulated operations with enough precision, do not deal equitably with fixed, utility-related costs, and do not reflect a unified approach to cost allocation. With the assistance of the parties, the Commission could design a comprehensive cost allocation system. It is unnecessary to commit the resources of parties and state regulators to this project, however, since the FCC has already developed a comprehensive cost allocation framework that will meet the needs of this case.

The FCC cost separations principles were developed after extensive public comment and have worked successfully since their adoption in 1986. They address the problems this case presents. They require direct assignment of costs whenever possible and provide a theoretical framework for allocating joint and common costs. Most important, they do not allocate unregulated costs on the basis of incremental cost, i.e., costs over and above those necessary to operate the regulated utility. They ensure that regulated and unregulated operations share equally in any cost savings realized due to joint operations. The Commission believes the FCC separations approach will provide a just and reasonable cost allocation procedure for Minnegasco.

### **C. Proper Allocation of the Costs of Gas Leak and Carbon Monoxide Checks**

MAC challenged the Company's practice of allocating to regulated operations the full cost of checking for natural gas and carbon monoxide leaks. Company technicians check for natural gas and carbon monoxide leaks every time they make an appliance installation or repair visit. The Company charges the costs to regulated operations on the theory that these checks increase the safety of the gas distribution system and promote public confidence in the safety of natural gas. Company records show that 48% of the gas leaks detected in the system are detected by unregulated operations, 38% by utility operations, and 14% by combined operations.

The Commission is unclear at this point on how the costs of performing natural gas leak checks should be allocated. Obviously, system safety is a primary responsibility of regulated operations. This cuts in favor of charging the costs to the regulated side of the ledger. On the other hand, checking for gas leaks on every appliance installation and repair visit may be an unnecessarily broad and expensive approach to leak detection. The Commission will require the Company to file an explanation of



why it selected its current leak detection program, a description of alternative approaches, and estimates of the costs of alternative approaches. The Commission is not persuaded that the current level of leak surveys is properly allocable to the regulated utility.

The Commission believes that the costs of conducting carbon monoxide checks should be allocated entirely to unregulated operations. Although these checks are important safety measures, they are not an integral part of providing utility service. In fact, they are an integral part of installing and repairing gas appliances. Carbon monoxide checks are routinely performed by all plumbing and heating contractors who install and repair gas appliances; it is in that unregulated role that Minnegasco performs them. These costs will be allocated to unregulated operations in the future.

#### **D. Preferential Treatment Allegations**

The Commission finds that this record contains no evidence of a pattern of Minnegasco giving preferential treatment to ratepayers who use its appliance sales and repair services. MAC provided two examples of alleged preferential treatment; both occurred before the generic appliance sales and service investigation, In the Matter of an Investigation into the Competitive Impact of Appliance Sales and Service Practices of Minnesota Gas and Electric Utilities, Docket No. G,E-999/CI-90-1008. The Company dealt with both situations promptly and appropriately. There is no reason to view them as anything other than isolated incidents.

The Commission is aware of the potential for institutional and personal conflicts of interest created by Minnegasco's operation of an appliance sales and repair business. Clearly, the Company could be tempted to use its control over gas installation schedules to favor gas appliance customers; individual employees could be tempted to manipulate those schedules to increase their chances of earning sales commissions. At the same time, however, the record is devoid of any evidence that these potential conflicts have resulted in a pattern of discriminatory treatment of ratepayers. The Commission concludes MAC's allegations require no further action, but will continue to monitor Minnegasco's performance in this area.

#### **E. Safety Issues Raised by MAC**

MAC contended generally that Minnegasco's appliance sales and repair operations could jeopardize the safety of its system. There is no evidence of this in the record.

Furthermore, it would appear that if the appliance sales and repair operations had any effect on safety, it would be to enhance system safety. The gas leak checks performed during service calls increase overall system safety. The carbon monoxide checks increase the safety of the households where they are performed. If the Company's interest in selling and

repairing appliances should cause it to urge premature repair and replacement of gas appliances, that, too, would increase overall system safety. (It would, of course, raise consumer fraud issues discussed below.) The Commission concludes Minnegasco's appliance sales and repair operations do not jeopardize system safety.

**F. Allegations of Inappropriate "Red-Tagging" and Consumer Fraud**

MAC's initial complaint included allegations that Minnegasco had abused its authority to "red tag" (label dangerous and in need of immediate replacement) furnaces, by red tagging furnaces that did not meet red tag standards, to promote furnace sales. MAC failed to present substantiating evidence. The Commission and the Department have no complaints on the issue from customers. The Commission concludes there is no pattern or practice of Minnegasco abusing its red tag authority.

Similarly, the initial complaint included an allegation of consumer fraud in a case involving installation of a boiler under warranty from the Company. The Company provided a plausible explanation for its conduct in that case, which appears to be an isolated incident. There is clearly no pattern of consumer fraud in Minnegasco's operation of its appliance sales and repair business.

**G. Whether Improprieties Require Structural Separation**

MAC contended that Minnegasco's conduct of its unregulated appliance sales and repair operations has been so marked by misconduct that the only reasonable remedy is to require the Company to conduct those operations as an autonomous enterprise. The Commission disagrees.

While the Company's cost allocation procedures require improvement, they do not justify the punitive action MAC recommends. The Company appears to be using allocation procedures that fall somewhere between the fully allocated cost principles of the FCC and the incremental cost principles sometimes used in other regulatory contexts, such as setting competitive rates. While a fully allocated cost approach is more appropriate in this context, the Company was not outside the bounds of defensible business practice in using the approach it used. Two independent accounting firms retained by the Company to examine the relationship between its regulated and unregulated operations, Arthur Anderson and Coopers Lybrand, supported Minnegasco's cost allocations and concluded the Company's unregulated operations benefitted its regulated operations.

Similarly, the Company's allocation of technician time and use of technician time to allocate other expenses appear somewhat arbitrary, but not wilfully fraudulent. Finally, MAC's allegations of discriminatory ratepayer treatment and abuse of

the Company's red tagging authority appear to be unfounded. Taken as a whole, the Company's conduct of its appliance sales and repair operations does not justify the extreme penalty of severing those operations from the regulated utility.

The Commission notes in this context that the Public Utilities Act requires utilities engaged in other businesses to keep their records in accordance with the requirements of federal and state regulatory agencies. Minn. Stat. § 216B.10, subd. 2 (1990). The Commission interprets this to mean that regulated utilities may engage in other businesses to the extent that conducting those businesses does not conflict with the public interest and the policies of the Public Utilities Act.

#### **H. Minnegasco's Motion**

On September 8, 1992 the Company filed a motion asking the Commission to defer all cost allocation issues to its ongoing rate case, to dismiss MAC's claims of preferential treatment and conflict of interest, and to deny MAC's request to order complete structural separation of the Company's regulated and unregulated operations. Since resolution of the complaint on the merits addresses all issues raised in the motion, the motion is moot.

### **III. Conclusion**

The Commission finds that this docket, not the Company's ongoing general rate case, is the appropriate vehicle for addressing the issues of the MAC complaint. The defects in the Company's current cost allocations procedures can and should be remedied by application of the FCC cost allocation principles. There is no evidence in this record of improper red tagging or preferential treatment of ratepayers using the Company's appliance sales and repair services. There is no evidence in this record that the Company's unregulated operations jeopardize the safety of its regulated operations. Deficiencies in the Company's operation of its appliance sales and repair business do not rise to a level requiring structural separation of the Company's regulated and unregulated operations.

#### **ORDER**

1. Minnegasco shall adopt and implement the cost allocation principles developed and applied by the Federal Communications Commission.

2. If Minnegasco wishes to allocate any cost related to its appliance sales and repair business to regulated operations, the Company shall file with the Commission and the Department a full description of the cost and an explanation of its reasons for believing the cost should be allocated to regulated operations. Such costs include regulatory, legal, and administrative costs, particularly those associated with this docket and the generic appliance sales and service investigation, docket number G, E-999/CI-90-1008. These filings shall be made on or before November 30, 1992.
3. Minnegasco shall develop and submit for Commission consideration alternative allocation methods for the following expense categories: labor overheads, supervision, other expenses, information services, CPU time, clerical payroll, taxes and benefits, depreciation, property taxes, and general and administrative payroll and expense. These filings shall be made on or before November 30, 1992.
4. Minnegasco shall file detailed data showing cost allocations for accounting and data processing services, including actual dollars, numbers of personnel, and proposed allocation formulas, using 1992 data. This filing shall be made on or before November 30, 1992.
5. Minnegasco shall file dollar amounts and allocation formulas used to allocate upper management labor costs, using 1992 data, on or before November 30, 1992.
6. Minnegasco shall allocate the entire cost of performing carbon monoxide checks to unregulated operations.
7. Minnegasco shall make a filing explaining why it selected its current leak detection program, a description of alternative approaches, estimates of the costs of alternative approaches, and a comparison of the advantages and disadvantages of each. This filing shall be made on or before November 30, 1992.
8. Parties shall file any comments on any of the filings required above within 20 days of the date they are filed with the Commission.
9. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster  
Executive Secretary

(S E A L)